NOTES AND MEMORANDA.

THE RISK THEORY OF PROFITS.

Every one who has read Mr. F. B. Hawley's paper on "Enterprise and Profit" in this Journal for November, 1900, must have been impressed with the keenness of his insight into many difficult problems and the clearness with which he set forth his views. Nevertheless, there are one or two criticisms which, in the opinion of the writer, are worth suggesting.

The difficulty is not so much with the proposition that the essential function of the entrepreneur is risk-taking as with the proposition that profits are the reward for risk-taking. This difficulty is suggested by Mr. Hawley himself in his discussion of insurance (p. 94). He contends, correctly, that insurance is not the reward for undergoing risk. The real reward of the insurer "is to be found not in the amount of premiums received, but in the difference between that amount and the losses consequent upon assuming the risk." Here the question arises, How does there happen to be this difference? Evidently, because the risk to the insurer is less than to the insured. In fire insurance, for example, the loss to the insured in case of fire would include not only the money value of the buildings or goods destroyed, but also shrunken credit and crippled business, besides the sharply accentuated subjective loss due to the fact that a large share of his income for a given period had been cut off. To the insurer the loss is the simple money value of the buildings or goods destroyed. Though the shifting of the risk from the insured to the insurer does not diminish the number of losses, the amount of risk is diminished because each loss is smaller: it bears less heavily upon the insurer than it would upon the insured. Therefore, the insured can afford to pay in premiums more than enough to enable the insurer to meet his losses.

This familiar principle of insurance explains how it is that

there are *profits* of insurance. It also suggests that these profits of insurance are a kind of risk-taker's rent. They owe their existence to the fact that they are not the reward of risk-taking, but that they are the surplus over and above the real risk assumed.

It is evident that in the case of the entrepreneur, as well as in that of the insurance company, so much of his gross income as goes to cover his real risk, or to make good his losses, is not to be classed as profit. Only that which remains after the losses are met deserves that name. How does there happen to be a remainder? Evidently, because the risk to the entrepreneur is less than to those whom he relieves of it. There is no reason for believing that a given loss would fall less heavily upon him than upon those whom he relieves, but there are reasons for believing that the amount and number of losses experienced by the skilled entrepreneur are less than would be experienced by those whom he relieves of the risk. This is due to no actuarial principle, as in the case of the insurance company, but to superior foresight and skill in avoiding losses. His real net income is, therefore, properly called risk-taker's rent, and is due, not to the risks which he assumes, but to the risks which he does not assume. Stated more accurately, the fact that he relieves others of their risks may account for his gross income; but his net income, or profit, arises from the fact that he is able to reduce his own risk below that which others would have to carry. This last way of stating the case makes it apparent that profits are, after all, payment for superior foresight and managerial skill, even though we admit that the entrepreneur is essentially a risk-taker.

Mr. Hawley's criticism of those who took part in the discussion of Professor Emery's paper at the meeting of the American Economic Association in 1899 * seems to the writer to be based upon a mere matter of definition. Those who held that the speculator produces time utility had in mind the one who assumes commercial as distinguished from industrial risks; *i.e.*, the one who buys goods in expectation of a rise in price and for the sole purpose of selling again when the price

* Publications of the American Economic Association, Third Series, vol. i. No. 1, pp. 103–122.

rises. This will be found to be in accord with the commonly accepted definition; but Mr. Hawley defines such a one as an entrepreneur, and narrows down the definition of a speculator to that of one who merely bets on the course of the market. On the basis of this definition he finds it easy to prove that "the speculator has no place at all in a theory of distribution, or, what would be a better name for it, in the theory of productive distribution."

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MUNICIPAL TRADING IN GREAT BRITAIN.

During the last two or three years nothing in Local Administration has been more keenly discussed in England than the question of the limits of municipal enterprise. The constant increase of powers sought and often obtained from Parliament by the English towns has been accompanied among the commercial classes by a growing opposition to certain forms of municipal activity, which are commonly classed as "trading." It has been generally felt that it is time for Parliament to adopt some more definite line of policy than it has hitherto taken, but such a policy is not easily determined upon. On the one side there are the towns, which demand more power of action without the constant necessity of seeking parliamentary authority; on the other side are the trading companies, which ask that the action of the municipalities may be restrained. Consequently, last year a parliamentary Joint Committee of Lords and Commons was appointed, to consider the whole matter, and "to report as to the principles which should govern powers given by Bills and Provisional Orders to municipal and other local authorities, for industrial enterprise within or without the area of their jurisdiction." That Committee, which was fairly representative of political parties, and did not vary greatly from the general average of ability displayed by parliamentary committees, was appointed late in the session; and after sixteen meetings its work was inter-